

CC:INTL:0822-89

P.Bray, Br2

MAR - 9

Larry Edgar
International Examiner

David Bower
Senior Technical Reviewer

Section 883 exemption for shipping income

THIS DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE AND THE ATTORNEY WORK-PRODUCT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE OUTSIDE THE IRS, INCLUDING THE TAXPAYER(S) INVOLVED, AND ITS USE WITHIN THE IRS SHOULD BE LIMITED TO THOSE WITH A NEED TO REVIEW THE DOCUMENT FOR USE IN THEIR OWN CASES.

In a letter to Mr. Kim Palmerino, dated November 8, 1989, you asked whether certain income earned in [REDACTED] would be excluded from gross income under section 883 of the Internal Revenue Code. The income is derived by a corporation organized in [REDACTED] which operates a cruise ship between [REDACTED] and [REDACTED].

The [REDACTED] purchased by the passengers through a tour company is a [REDACTED] day/[REDACTED] night package. The first [REDACTED] include a [REDACTED] within [REDACTED]. On the [REDACTED] the passengers travel [REDACTED] board the ship. The next [REDACTED] include the cruise portion of the vacation package. On the [REDACTED] and [REDACTED], the ship sails through [REDACTED] and on to [REDACTED]. On the [REDACTED] the ship makes a port of call at [REDACTED], where the passengers disembark for sightseeing for the day. The [REDACTED] the ship docks at [REDACTED], where the passengers explore [REDACTED] for the day. On the [REDACTED] the ship makes another port of call at [REDACTED] where passengers may tour for the day. On [REDACTED] the ship cruises down the coastline of [REDACTED], and on [REDACTED] the passengers leave the ship in [REDACTED].

Your question is whether the income derived by the operator of the ship which is attributable to the cruise solely between the U.S. ports, i.e., between [REDACTED] and [REDACTED], is excludable under section 883 of the Code. ~~This income is excludable under section 883~~

08247

Larry Edgar
Section 883 exemption for shipping income

Section 883(a)(1) of the Code, as amended, provides that gross income derived by a corporation organized in a foreign country from the international operation of a ship shall not be included in gross income and shall be exempt from tax in the United States if the foreign country grants an equivalent exemption to corporations organized in the United States. The threshold question to resolve is whether the cruise company is organized in a country which grants an equivalent exemption for shipping income. The cruise company in this case is organized in [REDACTED] [REDACTED] grants an equivalent exemption as evidenced by an exchange of diplomatic notes with the United States. See, 1988-1 C.B. 463.

The next question to examine is whether the income derived by this corporation from operating the cruise outlined above is considered derived from the "international operation" of a ship. The term "international operation", which is not defined in the Code or regulations for purposes of section 883, was added to the Code by P.L. 100-647, the Technical Corrections Bill of 1988. The Senate Committee Report on P.L. 100-647 provides that the U.S. tax exemption under section 883 applies to gross income derived from international operations only, and not to gross income derived from U.S. operations. The Report explains that transportation income that would be sourced entirely in the United States under section 863(c)(1) is not eligible for this exemption.

In 1984, Congress added section 863(c) to the Code. This section provides source rules for certain transportation income, which is defined, in part, as income derived from the use of a vessel. Section 863(c)(1) provides that transportation income attributable to transportation that begins and ends in the United States is treated as derived from sources within the United States, i.e. it is considered 100 percent U.S. sourced. As explained above such income is not eligible for exemption under section 883. Section 863(c)(2), however, provides the rule for transportation income attributable to transportation which is not sourced under section 863(c)(1) and which begins or ends in the United States. Such income is considered to be 50 percent from United States sources. Thus, income derived from the operation of a ship and sourced under section 863(c)(2) is eligible for exemption under section 883. Therefore, income sourced under section 863(c)(2) can be considered to be derived from the "international operation" of a ship.

Larry Edgar
Section 883 exemption for shipping income

Further support for this interpretation is provided by the Joint Committee on Taxation's discussion of when transportation income will be considered to begin and end in the United States in the Explanation of the Tax Reform Act of 1984, at page 374 (the Blue Book). The Blue Book provides that "transportation of persons will not be considered to begin and end in the United States when it involves transportation from one U.S. point to an intermediate U.S. point en route to the persons' destination in a foreign country, provided the persons do not change vessels at the U.S. intermediate point." Thus, income from carrying passengers on the cruise ship from [REDACTED] to intermediate U.S. ports and on to [REDACTED] would not be treated as from transportation which begins and ends in the United States, where the passengers do not change vessels. Therefore, such transportation income would be treated as attributable to transportation which begins or ends in the United States under section 863(c)(2). It is clear from the Blue Book that where the passengers continue to their ultimate foreign destination on the original ship, even though the ship may make intermediate stops at U.S. ports, Congress did not intend that such travel be broken into separately sourced segments.¹ Instead, the transportation should be treated as one continuous voyage from the point of origin to the ultimate destination.

Because the entire cruise between [REDACTED] and [REDACTED] would be treated as attributable to transportation that begins or ends in the United States under section 863(c)(2), it would be considered to be from the international operation of a ship. Thus, the section 883(a) exemption would apply to the income derived by the

¹/ Another possible interpretation of the term "international operation" is found in the section 1.954-6(b)(3) definition the term "foreign commerce". The term is defined, in pertinent part for purposes of sections 951 through 964, as the transportation of property or passengers between a port in the United States or possession of the United States and a port in a foreign country, or between a port in a foreign country and a port in the same, or in another foreign country. For example, a cruise ship which visits one or more foreign ports is considered to be so used. Thus, the ship used in the cruise from [REDACTED] to [REDACTED] would be considered to be used in "foreign commerce" for purposes of sections 951 through 964.

Larry Edgar
Section 883 exemption for shipping income

██████████ corporation from the operation of the cruise ship between ██████████, ██████████ and ██████████ provided that the ownership requirements of section 883(c) are satisfied.

Your letter did not include any facts about the ownership of the ██████████ corporation operating the cruise ship. It is necessary for a corporation which satisfies the requirements of section 883(a) to also satisfy the ownership requirements of section 883(c) before it can exclude its shipping income from U.S. tax. We have enclosed a memorandum to another examiner which explains how the rules of section 883(c) should be applied. We hope this will be helpful.

Your letter did not address the issue which might arise with respect to income derived by the operator of the cruise ship from the ██████████ of the tour package. This issue involves policy decisions which are currently under study at the national office level. To help us in this effort, we would appreciate a brief memo from you or other examiners informing us of any fact patterns that you may encounter in your examinations involving foreign shipping or aircraft companies with income derived from ██████████ activities.